

General Information Letter: Quality control activities in Illinois, if not de minimus, are not protected under Public Law 86-272.

March 5, 2001

Dear:

This is in response to your letter dated June 27, 2000 in which you state the following:

As CPA for a Michigan base manufacturer, I hereby request your assistance in providing a letter ruling pertaining to Nexus guidance. My client performs sales through solicitation, and on request of its Illinois customer (single customer) performs quality control activities at customers' plant for its machine component parts shipped to Illinois.

At no time have our employees spent any two consecutive days in Illinois, nor has our total in-state activity exceeded thirty days each year. We maintain no office or employees within Illinois.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 201 of the Illinois Income Tax Act ("ITA"), 35 ILCS 5/101 et seq, imposes a tax measured by net income on corporations for the privilege of earning or receiving income in this State. The Due Process and Commerce Clauses of the Federal Constitution limit the power of States to subject foreign corporations to tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id.

Unless protected by Public Law 86-272, a foreign corporation has the requisite nexus to subject it to Illinois income tax where any part of its income is allocable to Illinois in accordance with the provisions of Article 3 of the Illinois Income Tax Act (35 ILCS 5/301-304, 308). Public Law 86-272 is a federal statute that prohibits a state's taxation of interstate sales of tangible personal property.

Your letter indicates that your client "performs sales through solicitation, and on request of its Illinois customer (single customer) performs quality control activities at customers' plant for its machine component parts shipped to Illinois." Although you mention having "sales" in the state of Illinois of which some of the sales are component parts shipped to Illinois, we cannot ascertain whether you are only selling tangible personal property. If yes, you would be correct as being protected under Public Law 86-272. However, if your corporation is not in the business of selling tangible personal property, your company is not protected by Public Law 86-272.

The fact that your client has employees performing quality control activities at a customers' plant in Illinois may give rise to the requisite nexus to subject your client corporation to Illinois Income tax.

Your letter indicates that your client's employees have not spent any two consecutive days in Illinois, but that the total in-state activity may be as high as spending 29 days in Illinois out of an entire year. Occasional visits to the state would probably satisfy the commerce and due process clauses. For example, in the New York case of Orvis v. Tax Appeals Tribunal, 86 N.Y.2d 165, 654 N.E.2d 954 (1995), the court found that four visits to nineteen customers in one year was enough to allow the state to tax a Vermont wholesaler.

If a corporation does establish nexus, business income will be apportioned to Illinois under Section 304 of the IITA. Illinois has used the 3-factor apportionment formula that takes into consideration the (1) payroll, (2) property and (3) sales of a corporation. Beginning with taxable years ending December 31, 2000, only sales will be used. This change to a "single-sales factor" will be phased in over a two-year period. Since your client seems to have no payroll or property within Illinois, the change does not effect your client. Should your client have "nexus" with Illinois, the client would use the amount of money that is retrieved from Illinois compared to the amount retrieved from all other states.

The question of nexus is highly fact-dependent. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. Such a determination can only be made in the context of an audit where a Department auditor has access to all relevant facts and circumstances. For that reason, we are referring your correspondence along with a copy of this letter to the Audit Technical Support Services Division.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 2 Ill.Adm.Code §1200.110(b).

Sincerely,

Heidi S. Scott
Staff Attorney – Income Tax